

Legislative Audit Division

State of Montana



Report to the Legislature

November 1997

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 1997

Montana Arts Council

This report contains an unqualified opinion and five recommendations to the council relating to:

- ▶ **Spending non-General Fund money first.**
- ▶ **Requesting federal cash based on need.**
- ▶ **Time and effort reporting.**
- ▶ **Indirect costs.**
- ▶ **Recording federal activity.**

**Direct comments/inquiries to:
Legislative Audit Division
Room 135, State Capitol
PO Box 201705
Helena MT 59620-1705**

FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act of 1984 and Amendments of 1996, and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1995 has been issued. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

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James Gillett, Financial-Compliance Audit

November 1997

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Montana Arts Council for fiscal years 1996 and 1997. The report contains five recommendations where the council could enhance compliance with state and federal laws and regulations. The council's written response to the audit is included in the back of the report.

We thank the Executive Director and staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

"Signature on File"

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 1997

Montana Arts Council

Members of the audit staff involved in this audit were Jim Manning, Vickie Murphy, and Paul J. O'Loughlin.

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Appointed and Administrative Officials

Montana Arts Council

		Term <u>Expires</u>
Bill Frazier (Chair)	Livingston	2000
Carol Novotne (Vice-Chair)	Fort Harrison	2002
Ann Cogswell	Great Falls	1998
Rick Halmes	Billings	1998
Sody Jones	Billings	1998
Diane M. Klein	Kalispell	1998
Jackie Parsons	Browning	1998
Kathy Doeden	Miles City	2000
Monte Dolack	Missoula	2000
Jack Hines	Big Timber	2000
Marilyn Olson	Sidney	2000
Carol Brenden	Scobey	2002
Connie Clarke	Miles City	2002
John Dudis	Kalispell	2002
Robert Mornson	Billings	2002

Administrative Officials

Arlynn Fishbaugh	Executive Director
Carleen Layne	Accountant

Report Summary

Montana Arts Council

We performed a financial-compliance audit of the Montana Arts Council for fiscal years ending June 30, 1996 and June 30, 1997. We issued an unqualified opinion on the financial schedules for each of the two fiscal years under audit. The reader may rely on the presented financial information and the supporting data on the Statewide Budgeting and Accounting System.

The audit report contains five recommendations to the council regarding the use of non-General Fund money first, federal cash management, time and effort reporting, indirect costs, and Federal Special Revenue Fund balances.

The listing below serves as a means of summarizing the recommendations contained in the report, the agency's response thereto, and a reference to the supporting comments.

<u>Recommendation #1</u>	We recommend the council ensure all other allowable funds are spent before using General Fund appropriations. 8
	<u>Agency Response:</u> Do not Concur. See page B-3.
<u>Recommendation #2</u>	We recommend the council adopt and follow procedures to monitor cash balances and draw federal cash based on need, in compliance with federal guidelines. 10
	<u>Agency Response:</u> Concur. See page B-3.
<u>Recommendation #3</u>	We recommend the council adopt procedures to document personnel activity levels as required by federal regulations. 11
	<u>Agency Response:</u> Concur. See page B-3.
<u>Recommendation #4</u>	We recommend the council:
	A. Properly record indirect cost activity on its accounting records in accordance with state law and state accounting policy.
	<u>Agency Response:</u> Concur. See page B-3.
	B. Obtain approval for an interim indirect cost rate and record indirect cost recoveries. 12
	<u>Agency Response:</u> Concur. See page B-4.

Report Summary

Recommendation #5

We recommend the council record federal grant activity
in accordance with state accounting policy. 13

Agency Response: Concur. See page B-4.

Introduction

Introduction

We performed a financial-compliance audit of the Montana Arts Council (council) for the two fiscal years ended June 30, 1997. The objectives of the audit were to:

1. Determine the council's compliance with applicable laws and regulations.
2. Make recommendations for improvement in the council's management and internal controls.
3. Determine if the council's financial schedules present fairly the results of its operations for the two fiscal years ended June 30, 1997.

The report contains five recommendations to the council. Areas of concern deemed not to have a significant effect on the successful operations of the council are not included in this report but have been discussed with management.

Background

The Montana Arts Council was established as a state agency in 1967. The council consists of 15 members who are appointed by the governor, confirmed by the Senate, and serve a five-year term. The council members are responsible for the governance, management, and control of the agency. The council's duties are to:

1. Encourage the study and presentation of the arts throughout the state.
2. Stimulate public interest and participation in the arts.
3. Cooperate with public and private institutions engaged in cultural and aesthetic activities.
4. Foster public interest in the cultural heritage of Montana and expand the state's cultural resources.
5. Encourage and assist freedom of artistic expression.

Programs such as Artists in Schools/Communities, Governor's Awards for the Arts, First Book Award, and Montana Folklife are designed by the council to expose Montanans to their artistic and cultural heritage. Organizational grants, fellowships, technical

Introduction

assistance and networking efforts help support both individual artists and art and cultural organizations.

The council has three sources of funding: federal grants from the National Endowment for the Arts (NEA), investment earnings from its coal tax supported Cultural Trust Fund, and support from the General Fund. General Fund support was \$132,016 and \$114,609 in fiscal years 1996 and 1997, respectively. The council had approximately five full-time equivalent employees in fiscal year 1997.

The council is authorized to use investment income from the Cultural Trust Fund for the protection of works of art in the state capitol and for other cultural and aesthetic projects. The trust fund's corpus must remain intact, and increases by the amount of the annual coal tax revenue allocations. Section 15-35-108, MCA, allocated 0.63 percent of coal severance tax revenues to the Cultural Trust Fund during fiscal years 1996 and 1997.

The 55th Legislature designated funds from the Cultural Trust Fund corpus to be used in Virginia City and Nevada City purchase. Additional information is included in note 4 on page A-12. Cultural and Aesthetics (C&A) grants are available to cultural organizations and units of state, local, and tribal governments. The council provides administrative support for the C&A project advisory committee in reviewing applications for cultural and aesthetics grants. The advisory committee recommends a prioritized list to the legislature for funding. The legislature determines which organizations will receive grants from the trust fund investment earnings and the council awards the money as specified by the legislature. The 54th Legislature in 1995, approved funding for 73 cultural and aesthetic projects in the 1997 biennium totaling approximately \$500,000.

The council only has one program on the accounting records, so it is difficult to assess based only on the accounting records, the various functions the council performs. To aide in this, council personnel consulted with audit staff to establish reasonable descriptions of council functions as follows:

- Service and Promotion - This category includes technical assistance to artists and organizations. It includes public meetings and conferences, providing information to the public upon request, and performing research and professional writing. It also includes services to schools, art organizations, and artists throughout Montana.
- Grant Technical Assistance - This category includes technical assistance with the council grant programs. It includes helping art organizations and others complete grant requests and status reports.
- Grant Administration - This category includes the time necessary to write grants, process council or federal grants and report the status of grants to the federal government.
- General Administration - This category includes general office duties, paying bills, payroll, budget work, council meetings, database maintenance, and staff professional development.

Beginning in August 1997, council employees began to track their time spent in each of the functions described above. Based on the hours from the study of a four week period, council personnel allocated the 1997 biennium expenditures on a pro forma basis to each of the categories to show how much of their time and expenditures are in each category.

The following table shows expenditures allocated by the council for the 1997 biennium. The allocations are reasonable based on the time study conducted.

Introduction

Table 1
Montana Arts Council Expenditure Activity

Type of Expenditures	Service & Promotion	Grant Technical Assistance	Grant Administration	General Administration	Total Agency Expenditures	Percent of Total
Personal Services	\$255,407	\$47,393	\$69,859	\$115,674	\$488,333	22.70%
Operating Expenditures	212,277	15,035	87,596	80,301	395,209	18.36%
Equipment	3,890	939	2,026	4,123	10,978	.51%
Grants	1,257,408				1,257,408	58.43%
Total	\$1,728,982	\$63,367	\$159,481	\$200,098	\$2,151,928	100%
Percent of Total	80.35%	2.94%	7.41%	9.3%	100%	

Source: Compiled by Montana Arts Council.

Prior Audit Recommendations

Prior Audit Recommendations

Our office performed the audit of the Montana Arts Council for the two fiscal years ended June 30, 1995. The audit report contained no recommendations.

Findings and Recommendations

Introduction

The council's operations are governed by state law and accounting policy as well as federal grant award requirements. The following sections deal with issues concerning compliance with state law and accounting policy as well as federal regulations.

State and Federal Compliance Issues

Spending Non-General Fund Money First

Section 17-2-108, MCA, states “. . . an office or entity of the executive, legislative, or judicial branch of state government shall apply expenditures against appropriated nongeneral fund money whenever possible before using general fund appropriations.”

The council receives several federal grants from the National Endowment of the Arts (NEA). They also receive a General Fund appropriation to supplement these federal funds. During fiscal years 1996 and 1997, we noted several instances where the council moved expenditures from the federal Special Revenue Fund to the General Fund. In all of these cases there were still federal funds and appropriation authority available for the council to use in the federal Special Revenue Fund. As a result in fiscal years 1996 and 1997, the General Fund was charged \$5,721 and \$31,822 which could have been charged to federal grants.

In addition, the spending restrictions for the council's Basic State Grant from the federal government are very broad. Any charges allowable under the Arts in Education Grant would also be allowable under the Basic State Grant. Since there was remaining authority available for grants in the Basic State Grant, the potential existed for additional expenditures of \$12,800 and \$1,629 in fiscal years 1996 and 1997 respectively, to be transferred from the Art in Education grant to the State Basic Grant, instead of being transferred to the General Fund. The four amounts above total \$51,972.

Personnel cited the following factors which they believed supported the use of General Fund moneys:

Findings and Recommendations

- The council is required to match federal funds one to one. They viewed the General Fund as the first source of match and the Cultural Trust in the state Special Revenue Fund as the second source.
- Federal regulations allow the council to carry unexpended federal grant funds forward to the next year, but they cannot carry unspent General Fund forward to the next year.
- Staff interpreted the law to mean all they had to do was charge costs to the federal grant and once the authority was used, they could transfer amounts to the General Fund, thereby spending non-General Fund money first.

The council should comply with state law by spending non-General Fund money first. If the council believes this law is in conflict with federal regulations, the council should seek an exemption from the law.

Recommendation #1

We recommend the council ensure all other allowable funds are spent before using General Fund appropriations.

Cash Management

The council receives federal assistance, (CFDA #s 45.003, 45.007, 45.011, 45.015, and 45.023), from the NEA for promotion and enhancement of the arts in Montana. Council staff are responsible for the oversight of the federal awards, monitoring expenditure levels, and requesting cash when needed from the NEA. Staff indicated it may take a week for funds to become available once they have requested them.

General requirements for federal assistance under the Single Audit Act provide guidance under cash management which state in part “. . . cash should be drawn only in amounts necessary to meet immediate needs or to cover program disbursements already made.” During our audit, we found that the council did not follow acceptable cash management procedures in accordance with federal guidelines.

Findings and Recommendations

We reviewed an 18 month period overlapping fiscal years 1996 and 1997 and found there were cash balances in three federal accounts that greatly exceeded expenditures. In some instances, excess cash was in the accounts which would have allowed operations to continue without cash draws for periods from three to nine months. We determined the average month end cash balances, approximate average monthly expenditures, and calculated an estimate of the interest earned on the excess cash as presented in the following table.

Table 2
Montana Arts Council
Schedule of Average Cash Balances,
Expenditures, and Interest Earned

<u>Account</u>	<u>Average Cash Balance</u>	<u>Average Expenditures</u>	<u>Interest Earned *</u>
Basic State Grant	\$79,598	\$27,695	\$ 6,352
Art in Education	30,633	3,891	2,316
Miscellaneous Grants	<u>68,773</u>	<u>14,913</u>	<u>5,199</u>
Estimated Total Interest Earned			<u>\$13,867*</u>

* Computed using an annual interest factor of 5.04 percent which is the State Treasurer's Fund Yield for fiscal year 1996 as determined by the State Board of Investments.

Source: Compiled by the Legislative Audit Division from SBAS.

The council's Executive Director said they drew large amounts of federal cash in fiscal year 1996 because they were concerned about the backlog of requests due to federal government shutdowns and winter storms. In addition, the director was concerned about threats that were made in Congress to eliminate all funding for the NEA immediately. The council accountant said increased work loads, staff reductions, and demands of the 1997 legislative session contributed to the lack of monitoring cash balances in fiscal years 1996 and 1997. Based on our review of the timing and amounts of federal cash requested, there was inadequate monitoring of federal cash

Findings and Recommendations

balances by the council. The council is not in compliance with federal cash management regulations which could affect the council's eligibility for a letter of credit cash draw or impact future funding levels.

Recommendation #2

We recommend the council adopt and follow procedures to monitor cash balances and draw federal cash based on need, in compliance with federal guidelines.

Time and Effort Reporting

Office of Management and Budget (OMB) Circular A-87 defines allowable costs and cost principles with respect to entities receiving federal awards. Under these guidelines the council is required to maintain sufficient documentation to support personal services charges to federal programs. In fiscal years 1996 and 1997, we found the council did not maintain sufficient documentation of personal services charges to its federal Basic State Grant (CFDA # 45.003) and Arts in Education grant (CFDA # 45.007).

The council's personal services by fiscal year and by fund type are noted below:

<u>Fund Type</u>	<u>Fiscal Year 1996</u>	<u>Fiscal Year 1997</u>
General Fund	\$ 60,479	\$ 51,474
State Special Revenue Fund	116,576	72,070
Federal Special Revenue Fund	<u>165,833</u>	<u>54,674</u>
Total	<u>\$342,888</u>	<u>\$178,218</u>

The council's executive director stated that all activity is in support of the federal awards under "Promotion of the Arts" and while separate time and effort reporting was not done in the past, they did use time sheets to record total hours worked. Beginning in fiscal year 1998, council staff began documenting time spent in support of individual activities.

Findings and Recommendations

Since General Fund and state Special Revenue Fund moneys are used as match against the federal awards it seems reasonable that activity charged in the General Fund and state Special Revenue Fund are in support of the federal grants "Promotion of the Arts" activity, however, during the audit period, the council did not have documentation to demonstrate compliance with federal regulations.

Recommendation #3

We recommend the council adopt procedures to document personnel activity levels as required by federal regulations.

Indirect Costs

Section 17-3-111, MCA, requires grantee agencies to recover indirect costs (IDC) to the fullest extent possible in accordance with federal regulations and guidelines. The council is able to claim the costs allocated to it through the statewide cost allocation plan developed by the Department of Administration. Management Memo 2-88-2 provides guidance for the recording of IDC activity. During our review of the council's IDC transactions we noted areas where the recording of IDC activity did not comply with state law and accounting policy.

Classifications exist in the state's accounting system to distinguish federal grant assistance revenues from federal indirect cost recovery revenues and to provide for the recognition of current and prior year revenues and expenditures. We noted the following when reviewing transactions. The council:

- Did not record revenues to distinguish between the IDC recoveries and grant assistance in either fiscal year 1996 or 1997 in the federal Special Revenue Fund.
- Processed transactions using improper control accounts related to current year activity, prior year activity, and fund balance.

We further noted the council did not recover any IDC related to fiscal year 1997 activity. Council staff noted they have not yet prepared an indirect cost proposal due to delays in receiving the

Findings and Recommendations

statewide cost allocation plan. While there may be a delay in preparing the proposal and receiving federal approval, the council can ask for a temporary approved rate and recover indirect costs. If the council does not have an approved rate they would at least be able to estimate the amount of IDC recovery and record the activity.

Section 17-1-102 (4), MCA, requires all state agencies to input the necessary transactions to the accounting system by fiscal year-end to properly reflect the financial position of the agency. The improper recording of activity resulted in insignificant errors in the accounting records; however, council staff should review its accounting procedures for recording IDC activity to ensure compliance with state law and state accounting policy.

Recommendation #4

We recommend the council:

- A. Properly record indirect cost activity on its accounting records in accordance with state law and state accounting policy.**
- B. Obtain approval for an interim indirect cost rate and record indirect cost recoveries.**

Fund Balances in the Federal Special Revenue Fund

Special accounts exist within the Special Revenue Fund to account for federal grant activity. If transactions are accounted for correctly, ending fund balances of federal accounts should generally be zero. During fiscal year 1996 the council moved miscellaneous federal grants to a new account. While moving the activity, personnel made errors in some accounting entries which affected fund balances. Personnel attempted to fix the errors, but did not fix them appropriately. At the end of fiscal year 1996 one account had a fund balance of \$29,376, while two others had negative fund balances of \$27,946 and \$130.

In fiscal year 1997, personnel tried to fix the problem again. When correcting the error they incorrectly used Deferred Revenue rather

Findings and Recommendations

than Cash. This resulted in overstatements/understatements in one accounting entity and corresponding understatements/overstatements in another accounting entity. We also found in fiscal year 1997, personnel did not accrue revenue to the extent expenditures had been charged. This understates fund balance.

Management memo 2-96-14 provides that federal cash owed to the agency but not collected should be recorded as a receivable and federal cash collected but not spent should be reported as deferred revenue. Personnel indicated they did not fully understand which accounts to use when making adjustments or corrections and state accounting bureau personnel were not available at the time to assist them.

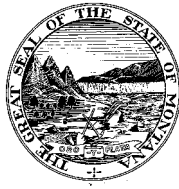
Recommendation #5

We recommend the council record federal grant activity in accordance with state accounting policy.

Independent Auditor's Report & Agency Financial Schedules

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying financial schedules of the Montana Arts Council for each of the two fiscal years ended June 30, 1996 and 1997, as shown on pages A-5 through A-13. The information contained in these financial schedules is the responsibility of the council's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than generally accepted accounting principles. The schedules are not intended to be a complete presentation and disclosure of the council's assets and liabilities.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the Montana Arts Council for the two fiscal years ended June 30, 1996 and 1997, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

"Signature on File"

James Gillett, CPA
Deputy Legislative Auditor

July 31, 1997

MONTANA ARTS COUNCIL
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 1997

	General Fund	Special Revenue Fund	Nonexpendable Trust Fund
FUND BALANCE: July 1, 1996	\$ <u>(7,670)</u>	\$ <u>306,781</u>	\$ <u>7,466,596</u>
ADDITIONS			
Budgeted Revenues & Transfers-In		994,099	498,695
Nonbudgeted Revenues & Transfers-In (Note 4)	7,352		
Prior Year Revenues & Transfers-In Adjustments			
Cash Transfers In (Out)	101,060		(3,677,714)
Direct Entries to Fund Balance		(223)	
Total Additions	<u>108,412</u>	<u>993,876</u>	<u>(3,179,019)</u>
REDUCTIONS			
Budgeted Expenditures & Transfers-Out	114,787	990,485	
Nonbudgeted Expenditures & Transfers-Out (Note 4)			498,695
Prior Year Expenditures & Transfers-Out Adjustments	(178)		
Total Reductions	<u>114,609</u>	<u>990,485</u>	<u>498,695</u>
FUND BALANCE: June 30, 1997	\$ <u><u>(13,867)</u></u>	\$ <u><u>310,172</u></u>	\$ <u><u>3,788,882</u></u>

This schedule is prepared from the Statewide Budgeting and Accounting System . Additional information is provided in the notes to the financial schedules beginning on page A-11.

MONTANA ARTS COUNCIL
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 1996

	General Fund	Special Revenue Fund	Nonexpendable Trust Fund
FUND BALANCE: July 1, 1995	\$ <u>(5,622)</u>	\$ <u>(933)</u>	\$ <u>7,236,238</u>
ADDITIONS			
Budgeted Revenues & Transfers-In (Note 4)		1,220,545	587,588
Nonbudgeted Revenues & Transfers-In	2,161		
Prior Year Revenues & Transfers-In Adjustments		(3,733)	
Cash Transfers In (Out)	127,807		230,358
Direct Entries to Fund Balance		4,455	
Total Additions	<u>129,968</u>	<u>1,221,267</u>	<u>817,946</u>
REDUCTIONS			
Budgeted Expenditures & Transfers-Out	132,016	913,383	
Nonbudgeted Expenditures & Transfers-Out (Note 4)		15,000	587,588
Prior Year Expenditures & Transfers-Out Adjustments		(14,830)	
Total Reductions	<u>132,016</u>	<u>913,553</u>	<u>587,588</u>
FUND BALANCE: June 30, 1996	\$ <u><u>(7,670)</u></u>	\$ <u><u>306,781</u></u>	\$ <u><u>7,466,596</u></u>

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional Information is provided in the notes to the financial schedules beginning on page A-11.

MONTANA ARTS COUNCIL
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 1997

	General Fund	Special Revenue Fund	Nonexpendable Trust Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS				
Charges for Services	\$ 7,352			\$ 7,352
Investment Earnings			\$ 498,695	498,695
Grants, Contracts, Donations and Abandonments		\$ 14,000		14,000
Other Financing Sources		608,695		608,695
Federal		371,404		371,404
Total Revenues & Transfers-In	<u>7,352</u>	<u>994,099</u>	<u>498,695</u>	<u>1,500,146</u>
Less: Nonbudgeted Revenues & Transfers-In	7,352			7,352
Prior Year Revenues & Transfers-In Adjustments				0
Actual Budgeted Revenues & Transfers-In	<u>0</u>	<u>994,099</u>	<u>498,695</u>	<u>1,492,794</u>
Estimated Revenues & Transfers-In		1,168,516	525,983	1,694,499
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 0</u>	<u>\$ (174,417)</u>	<u>\$ (27,288)</u>	<u>\$ (201,705)</u>
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS				
Charges for Services				
Investment Earnings			\$ (27,288)	\$ (27,288)
Grants, Contracts, Donations and Abandonments				
Other Financing Sources		\$ (27,288)		(27,288)
Federal		(147,129)		(147,129)
Budgeted Revenues & Transfers-In Over (under) Estimated	<u>\$ 0</u>	<u>\$ (174,417)</u>	<u>\$ (27,288)</u>	<u>\$ (201,705)</u>

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-11.

MONTANA ARTS COUNCIL
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 1996

	General Fund	Special Revenue Fund	Nonexpendable Trust Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS				
Charges for Services	\$ 2,161			\$ 2,161
Investment Earnings			\$ 587,588	587,588
Other Financing Sources		\$ 623,588		623,588
Federal		593,224		593,224
Total Revenues & Transfers-In	2,161	1,216,812	587,588	1,806,561
Less: Nonbudgeted Revenues & Transfers-In	2,161			2,161
Prior Year Revenues & Transfers-In Adjustments		(3,733)		(3,733)
Actual Budgeted Revenues & Transfers-In	0	1,220,545	587,588	1,808,133
Estimated Revenues & Transfers-In		1,277,224	512,082	1,789,306
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 0	\$ (56,679)	\$ 75,506	\$ 18,827
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS				
Investment Earnings			\$ 75,506	75,506
Grants, Contracts, Donations and Abandonments		\$ (35,000)		(35,000)
Other Financing Sources		75,506		75,506
Federal		(97,185)		(97,185)
Budgeted Revenues & Transfers-In Over (under) Estimated	\$ 0	\$ (56,679)	\$ 75,506	\$ 18,827

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional Information is provided in the notes to the financial schedules beginning on page A-11

MONTANA ARTS COUNCIL
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 1997

	<u>Promotion Of The Arts</u>	<u>Total</u>
PROGRAM EXPENDITURES & TRANSFERS-OUT BY OBJECT		
Personal Services		
Salaries	\$ 139,080	\$ 139,080
Other Compensation	3,450	3,450
Employee Benefits	<u>35,688</u>	<u>35,688</u>
Total	<u>178,218</u>	<u>178,218</u>
Operating Expenses		
Other Services	94,471	94,471
Supplies & Materials	9,944	9,944
Communications	25,004	25,004
Travel	20,300	20,300
Rent	20,309	20,309
Repair & Maintenance	332	332
Other Expenses	<u>12,287</u>	<u>12,287</u>
Total	<u>182,647</u>	<u>182,647</u>
Equipment & Intangible Assets		
Equipment	<u>7,870</u>	<u>7,870</u>
Total	<u>7,870</u>	<u>7,870</u>
Grants		
From State Sources	471,865	471,865
From Federal Sources	<u>264,493</u>	<u>264,493</u>
Total	<u>736,358</u>	<u>736,358</u>
Transfers		
Accounting Entity Transfers	<u>498,695</u>	<u>498,695</u>
Total	<u>498,695</u>	<u>498,695</u>
Total Program Expenditures & Transfers-Out	<u>\$ 1,603,788</u>	<u>\$ 1,603,788</u>
PROGRAM EXPENDITURES & TRANSFERS-OUT BY FUND		
General Fund	\$ 114,609	\$ 114,609
Special Revenue Fund	990,485	990,485
Nonexpendable Trust Fund	<u>498,695</u>	<u>498,695</u>
Total Program Expenditures & Transfers-Out	<u>1,603,789</u>	<u>1,603,789</u>
Less: Nonbudgeted Expenditures & Transfers-Out (Note 4)	498,695	498,695
Prior Year Expenditures & Transfers-Out Adjustments	<u>(178)</u>	<u>(178)</u>
Actual Budgeted Expenditures & Transfers-Out	1,105,272	1,105,272
Budget Authority	<u>1,509,272</u>	<u>1,509,272</u>
Unspent Budget Authority	<u>\$ 404,000</u>	<u>\$ 404,000</u>
UNSPENT BUDGET AUTHORITY BY FUND		
General Fund	\$ 1,087	\$ 1,087
Special Revenue Fund	402,913	402,913
Nonexpendable Trust Fund	<u>0</u>	<u>0</u>
Unspent Budget Authority	<u>\$ 404,000</u>	<u>\$ 404,000</u>

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-11.

MONTANA ARTS COUNCIL
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 1996

PROGRAM EXPENDITURES & TRANSFERS-OUT BY OBJECT	<u>Promotion Of The Arts</u>	<u>Total</u>
Personal Services		
Salaries	\$ 244,158	\$ 244,158
Other Compensation	4,075	4,075
Employee Benefits	61,251	61,251
Total	<u>309,484</u>	<u>309,484</u>
Operating Expenses		
Other Services	92,104	92,104
Supplies & Materials	11,840	11,840
Communications	28,917	28,917
Travel	43,222	43,222
Rent	25,746	25,746
Repair & Maintenance	586	586
Other Expenses	10,100	10,100
Total	<u>212,515</u>	<u>212,515</u>
Equipment & Intangible Assets		
Equipment	2,929	2,929
Total	<u>2,929</u>	<u>2,929</u>
Grants		
From State Sources	149,468	149,468
From Federal Sources	350,742	350,742
From Other Sources	5,600	5,600
Total	<u>505,810</u>	<u>505,810</u>
Transfers		
Accounting Entity Transfers	602,419	602,419
Total	<u>602,419</u>	<u>602,419</u>
Total Program Expenditures & Transfers-Out	<u>\$ 1,633,157</u>	<u>\$ 1,633,157</u>
PROGRAM EXPENDITURES & TRANSFERS-OUT BY FUND		
General Fund	\$ 132,016	\$ 132,016
Special Revenue Fund	913,553	913,553
Nonexpendable Trust Fund	587,588	587,588
Total Program Expenditures & Transfers-Out	<u>1,633,157</u>	<u>1,633,157</u>
Less: Nonbudgeted Expenditures & Transfers-Out (Note 4)	602,588	602,588
Prior Year Expenditures & Transfers-Out Adjustments	(14,830)	(14,830)
Actual Budgeted Expenditures & Transfers-Out	<u>1,045,399</u>	<u>1,045,399</u>
Budget Authority	1,814,836	1,814,836
Unspent Budget Authority	<u>\$ 769,437</u>	<u>\$ 769,437</u>
UNSPENT BUDGET AUTHORITY BY FUND		
General Fund	\$ 3,241	\$ 3,241
Special Revenue Fund	766,196	766,196
Unspent Budget Authority	<u>\$ 769,437</u>	<u>\$ 769,437</u>

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional Information is provided in the notes to the financial schedules beginning on page A-11.

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 1997

1. **Summary of Significant Accounting Policies**

Basis of Accounting

The council uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental Funds. In applying the modified accrual basis, the council records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when the department incurs the related liability and it is measurable.

State accounting policy also requires the council to record the cost of employees' annual leave and sick leave when used or paid.

The council uses accrual basis accounting for the Nonexpendable Trust Fund. Under the accrual basis, as defined by state accounting policy, the council records revenues in the accounting period earned if measurable and records expenses in the period incurred, if measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the council received the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the Statewide Budgeting and Accounting System without adjustment.

Accounts are organized in funds according to state law. The council uses the following funds:

Notes to the Financial Schedules

Governmental Funds

General Fund - to account for all financial resources except those required to be accounted for in another fund.

Special Revenue Fund - to account for proceeds of specific revenue sources legally restricted to expenditures for specific purposes. The council's Special Revenue Funds include the Cultural and Aesthetic Projects account, State Building Art Acquisitions account and accounts to track grants from the National Endowment for the Arts.

Fiduciary Funds

Trust Funds - to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other governments or other funds. The council's Nonexpendable Trust Fund is the Cultural Trust Fund. A portion of the coal severance tax collections was deposited in this fund and the earnings from the fund were used for cultural and aesthetics projects.

2. Annual and Sick Leave

Employees at the council accumulate both annual and sick leave. The council pays employees for 100 percent of unused annual and 25 percent of unused sick leave credits upon termination. Accumulated unpaid liabilities for annual and sick leave are not reflected in accompanying financial schedules. At June 30, 1996 and at June 30, 1997, the council had a liability of \$22,452 and \$26,464, respectively.

3. Pension Plan

Employees are covered by the Montana Public Employees' Retirement System (PERS). The council's contribution to PERS was \$16,369 in fiscal year 1996 and \$9,369 in fiscal year 1997.

4. Nonexpendable Trust Fund

During the 55th Legislative Session in 1997, the legislature appropriated \$3,912,500 of the Cultural Trust Fund to the Montana Historical Society for the acquisition, renovation and preservation of the landmarks known as Virginia City and Nevada City. The cash was transferred from the council to the Montana Historical Society in May 1997, which is reflected in Cash Transfers on the Schedule of Changes in Fund Balance for the fiscal year ended June 30, 1997. The remaining cash transfers represent the amount of coal tax moneys allocated to the Cultural Trust Fund during the fiscal year.

Notes to the Financial Schedules

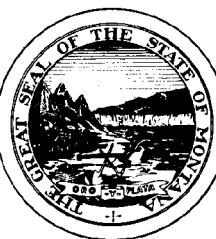
The Budgeted Revenues and Transfers-In represent interest earnings of the Cultural Trust Fund. These interest earnings, shown as Nonbudgeted Expenditures and Transfers-Out, are for cultural and aesthetic grants appropriated by the legislature and accounted for in the Special Revenue Fund.

5. General Fund Balance

The negative fund balance in the General Fund does not indicate overspent appropriation authority. The General Fund is a statewide fund. Each agency does not have a separate General Fund since its only authority is to pay obligations from the statewide General Fund within its appropriation limits. Each agency receives cash or other assets from the statewide fund when it pays General Fund obligations. The council's outstanding liabilities exceed the assets the agency has placed in the fund, resulting in negative ending fund balances for each of the two fiscal years ended June 30, 1996 and June 30, 1997.

Agency Response

MONTANA ARTS COUNCIL



MARC RACICOT, GOVERNOR

316 NORTH PARK AVENUE
CITY COUNTY BUILDING, ROOM 252

STATE OF MONTANA

(406) 444-6430
FAX: (406) 444-6548

PO BOX 202201
HELENA, MONTANA 59620-2201

November 6, 1997

To: Scott Seacat
Legislative Auditor

From: Arlynn Fishbaugh
Executive Director

A handwritten signature in cursive script, appearing to read "Arlynn Fishbaugh".

RE: Review of audit recommendations and agency response

We have reviewed the audit recommendations and enclosed you will find our position, contemplated corrective action and timetable for implementation on each recommendation.

Recommendation #1

We recommend the council ensure all other allowable funds are spent before using General Fund appropriations.

We respectfully cannot concur with this recommendation as concerns the legislative auditor's definition of allowable funds. As we understand it, the audit staff recommendation would require the council to spend any and all federal grant money whether it be from one or more distinctly different federal grants prior to spending any state money, despite the fact that the state general fund was originally designated as state match for a federal grant. This is the first time in the history of this agency, established in 1967, that this statute (Section 17-2-108, MCA) has been interpreted in this manner. We also have letters from the two applicable National Endowment for the Arts program directors, which are included, indicating that this recommendation constitutes supplanting of non-federal funds, which is prohibited by federal requirements. The support of general funds appropriated to this agency acknowledges the need for state fiscal participation in the performance of the program mission. A mechanical solution must be developed to avoid violating the law, or the agency should be exempt from it as are the Historical Society and State Library.

Recommendation #2

We recommend the council adopt and follow procedures to monitor cash balances and draw federal cash based on need, in compliance with federal guidelines.

We concur. Procedures will be implemented at once to monitor federal cash balances on a weekly basis and draw federal cash based on need, in compliance with federal guidelines.

Recommendation #3

We recommend the council adopt procedures to document personnel activity levels as required by federal regulations.

We concur. We have begun to utilize a function-specific time sheet developed with and reviewed by the legislative auditors to document staff time. We will be modifying the existing form to include allocation of time to specific federal grants.

Recommendation #4

We recommend the council:

A. Properly record indirect cost activity on its accounting records in accordance with state law and state accounting policy.

B. Obtain approval for an interim indirect cost rate and record indirect cost recoveries.

We concur. Staff will carefully review state law and accounting policy in implementing recommendation 4 A and will seek NEA approval for an interim indirect cost rate and record those indirect cost recoveries. We would ask the auditor to work with the Department of Administration to get statewide cost allocation plan information to the agency in a more timely fashion. We have only just received the FY 96 information, though it was prepared in March of 1997.

Recommendation #5

We recommend the council record federal grant activity in accordance with state accounting policy.

We concur. We will seek assistance from the legislative auditor and administration's accounting bureau to assure proper recording of federal grant activity. This will be fixed by fiscal year end.

10/25/1997 01:10 2026825602 — 0128197
To: ^{ph7k7} Jim Manning / Jim Gillett



NATIONAL ENDOWMENT FOR THE ARTS

The Nancy Hanks Center
1100 Pennsylvania Avenue NW
Washington DC 20506-0001
202/682-5400

October 27, 1997

Ms. Arlynn Fishbaugh
Executive Director
Montana Arts Council
P.O. Box 202201
Helena, Montana 59620-2201

Dear Arnie:

I am writing in response to your questions concerning the prohibition on supplanting non-federal funds, which is found on page 5 of our Partnership Agreement Guidelines. As used in these Guidelines, the term "supplant non-federal funds" can be defined as using federal arts dollars to replace state dollars appropriated for arts council programs or operations, with the intent or the effect of reducing a state's financial support of its state arts agency. As federal arts funding has decreased and as a greater percentage of that funding has been reserved for grants to state arts agencies, our advisory panels, the National Council on the Arts, and members of Congress have been especially concerned that this money not be used to replace state government support of the arts.

With respect to the first hypothetical situation, the use of federal funds to replace all state support for the Artists-in-Schools/Communities program would constitute supplanting if it was done with the intent or effect of reducing state support. It would also raise a problem with respect to matching if it resulted in failure to meet the matching requirement with respect to the Arts Education component - or any other component - of the Partnership Agreement award. Finally, such changes could require written NEA approval of amendment requests, depending on the amount of the shifts and the purposes for which the federal funding was to be used.

With respect to the second hypothetical situation, the use of federal funds to replace and reduce state support, based on the existence of unspent Basic State Grant funds, would constitute supplanting, as defined for the purposes of our Guidelines. I would note that it is not at all unusual - in fact it is extremely common - for state arts agencies to have unspent federal monies at the end of a fiscal year. This is due to the nature of state arts agency programming, with staff turnover, project delays, etc. It is certainly not due to any lack of need for arts support at the state level. If all states regarded the existence of unspent federal fund balances as an opportunity to reduce the state's own commitment, the result would be a gradual but steady erosion of state support for the arts. Such erosion would undermine the whole purpose of our federal-state partnership.

We believe that the longstanding partnership between the State of Montana and the NEA has brought substantial benefits to the people of Montana. However, the Arts Endowment expects

-2-

that its support will supplement and not supplant the support of state governments, which have the primary responsibility for supporting their own arts agencies.

I hope these responses are helpful. Please don't hesitate to contact me if I can answer any further questions, hypothetical or otherwise.

Sincerely,

A handwritten signature in dark ink, appearing to be 'Ed' or 'Edward', written in a cursive style.

Edward Dickey
State & Regional Director



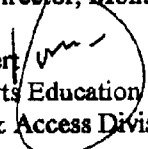
NATIONAL ENDOWMENT FOR THE ARTS

The Nancy Hanks Center
1100 Pennsylvania Avenue NW
Washington DC 20506-0001
202/682-5400

MEMORANDUM

DATE: October 20, 1997

TO: Arlynn Fishbaugh
Executive Director, Montana Arts Council

FROM: Doug Herbert 
Director, Arts Education
Education & Access Division

SUBJECT: Clarification of Arts Education Partnership Grant funds

As you know, the Arts Endowment's commitment to increasing and improving the quality of pre-K through grade 12 arts education has been an important part of our public partnership with the State arts agencies (SAAs) for many years. As of last year, the longstanding grant support category of Arts Education Partnerships Grants, from which competitive support is available only to the 56 SAAs, was made a part of the new State Partnership Agreements.

Prior to and now with the inclusion of these arts education support funds within the Partnership Agreements, a critical distinction between the Arts Education Partnership Grants and the other support that the Arts Endowment provides to the SAAs, specifically the Basic State Grants (BSG) and the Arts in Underserved Communities component, is the fact that the arts education funds are not allocated by virtue of a Congressional directive. That is to say, while Congress has specifically directed the Endowment to provide a percentage of our overall annual budget to the SAAs in the form of the BSG and Underserved support component, the Arts Education Partnership Grant support is allocated by the Endowment Chairman to supplement a State arts agency's financial commitment to arts education and to support efforts among the SAAs that are focussed on achievement of the mutually held partnership goals for arts education, as noted in the Partnership Agreement Guidelines.

To be more specific, our intention for these funds is to enable SAAs to better achieve their specific goals and objectives in pre-K - 12 arts education, an area that most, if not all, SAAs now consider a high priority within each of their state plans. Given that priority status, it stands to reason that these federal funds can be best used to supplement what should be a strong financial commitment to arts education by the SAAs. In fact, the relative importance of arts education in a given SAA's plan and its requisite financial commitment to achieving its arts education goals and objectives are important considerations of the peer advisory panels that annually review the SAAs' applications and recommend competitive funding.

Arlynn Fishbaugh
October 20, 1997
Page 2

I hope that this has sufficiently clarified our intention for the use of the Arts Education Partnership Grant funds, both in the recent past and today. However, if I can provide further information or clarifications, please don't hesitate to contact me.

cc: Ed Dickey
Ned Read